

# FINANCIAL OVERSIGHT

LESSONS ABOUT GRANT EXPENDITURE MONITORING

December 2012

## **FINANCIAL OVERSIGHT:** **Lessons about Grant Expenditure Monitoring**

Knight Foundation supports transformational ideas that promote quality journalism, advance media innovation, engage communities, and foster the arts. Through its arts program, the foundation seeks to weave the arts into the fabric of communities, to engage and inspire people and to contribute to a sense of place through shared cultural experiences. The foundation seeks innovative ways to reach, engage and increase audiences for the arts.



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# FOREWORD

**A**s a private foundation that achieves its mission using tax-exempt funds, the Knight Foundation must ensure that grantees appropriately spend funds to produce public benefit. This financial oversight responsibility led Knight to develop and launch the Grant Expenditure Monitoring (GEM) program in 2006 in partnership with accounting firm KPMG.

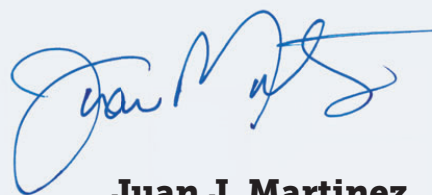
The GEM program plays a crucial role in maintaining compliance and accountability by supporting a series of financial reviews with Knight grantees. While the overwhelming majority of financial reviews conducted with grantees have indicated that projects were proceeding as planned and found no financial irregularities, a handful of reviews have turned up significant financial issues that prompted us to take corrective actions.

Though the GEM was originally conceived as purely a financial review, the process has also provided opportunities for Knight staff and grantees to collaborate more closely. The program has been a key resource for program staff by bringing KPMG's high level of business expertise to the complex operational issues that grantees face. Meanwhile, reviews have helped grantees identify ways to strengthen their capacities and operations.

To examine the impact of the GEM and improve its ongoing effectiveness, we commissioned a pair of assessments in 2011 which analyzed the design of the program from an accounting perspective and gathered feedback from grantees and staff. The assessments affirmed the value of the GEM program but also led us to make some key adjustments to the program.

This report outlines the lessons we have learned about financial oversight from managing the GEM program, and it provides guidance and helpful tools to support others interested in the program. The report contains our latest thinking, and discusses some of the ongoing adjustments we are making to the program based on key findings.

We hope that other funders—especially trustees and staff in finance and governance positions—will find this guide useful as they monitor and advance the work of their own grant partners.



**Juan J. Martinez**

Vice President/Chief Financial Officer



# INTRODUCTION AND SUMMARY

**T**he Knight Foundation collaborated with accounting firm KPMG to create the Grant Expenditure Monitoring program in 2006 to provide financial oversight to the usage of grant dollars. The Grant Expenditure Monitoring (GEM) program was created at a time when other funders were adopting similar processes for pre- or post-grant due diligence, and at a time when Knight was increasingly making large, multiyear grants in support of complex endeavors. Both trends underscored a growing need to understand the fiscal health and financial operations of grantees.

Between 2006 and 2011, KPMG conducted 230 GEM reviews of grants with a total value over \$482 million. The GEM program has cost on average \$570,000 per year, or \$15,600 per review, representing between 0.5 percent and 1 percent of the amount disbursed on grants during GEM's first six years. To assure that grantees view the GEM as a learning tool, its cost is embedded in the grant budget awarded to the grantee.

In that period, KPMG discovered no significant issues with 98 percent of the grants it reviewed, but the remaining 2 percent revealed either expenditure issues that needed to be addressed or significant operational issues that threatened the viability of the grant, or both. In the direst circumstances, the reviews led Knight to recover or redirect more than \$8.2 million of grant funds.

Importantly, though, the GEM program has become more than a tool for performing financial audits. The process reveals strengths and weaknesses in grantees' financial policies, practices and organizational capacities. The reviews help communicate these issues to Foundation staff between annual grant reports, while there is time to resolve problems before they affect project implementation. In short, the GEM reviews help program directors make better decisions and when done right, help grantees strengthen their internal controls and grant management abilities.

But no review program is perfect.

In 2011, Knight performed two assessments of the effectiveness and value of the GEM program, striving to analyze the impact of the program and make improvements. A team from RSM McGladrey Inc., a tax and accounting firm, examined the financial monitoring process for five randomly selected reviews that had been conducted by KPMG. Meanwhile, consultants from Metis Associates, a measurement and evaluation firm, surveyed 142 grantees (a 61 percent response rate) and interviewed 19 additional grantees, all of whom having participated in a review, about their experience with the GEM process. The Metis study also incorporated findings from interviews with Knight staff.

These evaluations found the GEM program to be a well-structured, proactive approach to providing financial management and oversight. Knight staff consistently ascribed value to the program, and several grantees discussed the benefits of the process.

That said, the evaluations also provided several recommendations for strengthening core components of the GEM program. First, the evaluators recommended scheduling GEM reviews using a risk-based approach and conducting different types of reviews that varied by intensity based on the level of underlying risk. Previously, Knight scheduled reviews primarily based on grant size, and all grantees received reviews of the same type and intensity.

Second, some grantees indicated that Knight could improve the way it set expectations for the GEM reviews and help grantees prepare for the process, including more specificity about the purpose and scope of reviews. Additionally, Knight could further clarify the timelines for the reviews and try to schedule reviews to align with the grant cycles and key internal milestones for the grantees.

Third, the evaluations revealed that Knight and KPMG needed to develop a more consistent approach to finalizing each review and addressing issues raised through the reviews. This included promoting clear roles and responsibilities, redesigning the findings report delivered after each review and determining how Knight would manage corrective actions suggested through the reviews.

As a result of these evaluation findings, Knight and KPMG began taking steps in 2012 to refine the program. The biggest change will include adopting a risk-based approach for determining which grant projects participate in GEM reviews. In this new approach, KPMG will shift away from implementing a one-size-fits-all model for reviews and instead provide three different types of reviews that vary by intensity based on the level of project risk.

This report is designed to help other funders implement and refine analogous financial oversight processes at their organizations. The first section walks through the five key components of the GEM review process, noting how Knight's approach has evolved over time. The next section discusses the impact of the GEM program on Knight and grantees, referring data from the two evaluations conducted in 2011. The final section shares lessons learned from designing and implementing the GEM program. The report also includes a Tool Kit section at the end with key documents used to manage the program.

Knight is still in the process of making changes to the GEM program based on the lessons learned so far. This report shares Knight's best thinking to date, acknowledging that the program will continue to evolve in the months and years ahead to account for learning and feedback received along the way.

### **Purpose of the Grant Expenditure Monitoring Program**

- To ensure financial compliance and accountability
- To communicate information and share knowledge between Foundation staff and grantees
- To identify opportunities for grantees to develop financial capacities
- Consulting on Improved governance structures
- Identifying needs for sustainability planning



# I. HOW THE GEM PROCESS WORKS

**K**night's finance department manages the GEM program. The GEM program involves a significant time commitment, especially for the chief financial officer, who oversees the process and spends an estimated 20 percent to 30 percent of his time managing the program.

The finance department has several key responsibilities throughout the GEM process. The CFO helps plan for each review, manages the resolution of key issues identified in reviews and reports observations to the Knight board of trustees' audit committee. Meanwhile, another staff member of the finance department coordinates the logistics of each review and ensures that Knight program staff and the grantees provide feedback about the findings in the final report shared by KPMG (see GEM Management Checklist for Foundation Staff in the Tool Kit section for a list of staff responsibilities).

After consulting with program directors to determine the time frame for each review, the finance team leads the coordination of key steps throughout the process. The team maintains an online schedule that tracks the progress of each GEM review from start to finish, along with the timing and flow of reports among KPMG, Knight staff and grantees. After the KPMG report has been finalized, Knight's grant's administration uploads the report into the grants management database.

The GEM program costs about \$570,000 per year, or 0.5 percent to 1 percent of the cost of grants funded by the Knight Foundation during GEM's first six years. The average review cost \$15,600, including travel and reporting costs. These costs have increased moderately since the end of 2011.

The rest of this section describes each of these components in greater detail, including what Knight has learned about each step over time and through the evaluations of the GEM program. The GEM process encompasses five important components:

- A. Selecting which grants receive reviews.**
- B. Scheduling and preparing for the review.**
- C. Conducting the review.**
- D. Reporting and discussing review findings.**
- E. Resolving issues.**

## A. SELECTING GRANTEES FOR REVIEW

At the outset of each grant, Knight Foundation determines whether the project will need a GEM review, or multiple reviews, during the grant period. Given the time and expense associated with each review, Knight performs GEM reviews with only a subset of grants each year and must prioritize which grants receive reviews.

Knight has gravitated toward a risk-based approach for selecting grantees for expenditure monitoring. Beginning in 2013, the foundation will require program directors developing new grants to complete a risk assessment tool (see Risk-Assessment Tool in the Tool Kit section) that rates the grant project according to 19 risk factors related to grant size and structure, grantee history, and organizational capacity for accounting and expense monitoring. Each answer carries a point value and the number of points helps determine which grantees receive reviews and the intensity of the review.

Knight's CFO views the risk assessment as an important tool for the program staff, not only for identifying whether and what type of GEM a specific grantee requires but for addressing and potentially mitigating risk in the grant development process before the project is implemented. Finance department staff are available to help program staff complete the risk assessment, and KPMG checks to see if the risk assessment has been completed properly and begins considering options to mitigate risks.

In addition to scheduling reviews based on this new risk-assessment tool, Knight program directors have the ability to identify existing grants they believe would benefit from a GEM review. Reviews requested on an ad hoc basis are added to the review schedule maintained by the finance department.

## SELECTING GRANTS FOR REVIEW

Knight originally conducted GEM reviews with all grantees that received over \$1 million. Large, complex, multiyear grants might receive two or more reviews during the grant period. Knight program staff could also request reviews for grants under \$1 million on an ad hoc basis if the project was especially complex or if they had concerns about the grantee's financial practices.

RSM McGladrey pointed out in their evaluation of the GEM that selecting grants to review primarily based on funding amount did not account for other important indicators of risk. This led Knight to explore using a risk-assessment tool to determine participation in the program, considering a wider range of factors such as experience managing grant funds, history of programmatic performance, financial stability and adequate management systems.

For example, Knight conducted an ad hoc review of a \$750,000 grant for an education program after the program officer raised questions about the grantee's financial condition. The GEM found that grant funds had been redirected to the grantee's general operations, leading Knight to suspend the grant before all funds were spent. Knight then provided the grantee with technical assistance to help develop a sustainability plan. If the risk-based method for scheduling reviews had been in place originally, staff would have better understood the grantee's financial practices during grant development.

## B. PREPARING FOR THE REVIEW



When grantees clearly understand the purpose of the GEM review and take steps to prepare, the process goes a lot more smoothly. This begins with the grant agreement, which sets expectations for the documents that Knight and KPMG will request, and grants Knight access to the grantee's financial records for the purposes of monitoring grant expenditures.

Knight's finance department leads internal preparation for reviews, including quarterly meetings with program staff to discuss upcoming reviews. Before each site visit, KPMG staff meets with Knight program staff and the CFO to discuss the grant and specific topics that KPMG should also explore during the review. Foundation staff also provides KPMG with electronic copies of all relevant grant documents.

Before the site visit, KPMG arranges a conference call with the grantee to discuss logistics. KPMG also emails the grantee a document request list (see Grantee Preparation Checklist and the KPMG Role in Review in the Tool Kit section) which asks for a variety of grant-related and organizational documents, including detailed general ledger reports, interim and final financial reports, invoices, receipts, vendor contracts and bank statements. Staff from KPMG review the documents provided by Knight and the grantee prior to the site visit.

### PREPARING FOR REVIEWS

The evaluation of the GEM confirmed that over 80 percent of grantees surveyed clearly understood the purpose of the GEM and over 70 percent understood the scope of the review. But 6 percent were not clear about the purpose and 10 percent desired more information about the scope of the review process and the topics that KPMG would explore.

The evaluation also gathered some feedback about the timing of the review. Grantees and Knight staff suggested timing the reviews to align with the grantee's budget cycle, and thought reviews should be scheduled to account for the grantee's internal commitments such as board meetings.





## C. CONDUCTING THE REVIEW

The GEM reviews focus on examining whether grant project expenditures are consistent with the terms of the approved grant budget. KPMG ensures that expenses are reported accurately and that items such as overhead and unspent funds are used appropriately. In some cases, KPMG also examines whether the grantees' financial operations reflect the best practices for business management.

Grantees must provide documentation showing that the claimed expenditures were actually made and were incurred for charitable purposes in accordance with the terms of the grant agreement. During a review, KPMG will draw a random sample of the grantee's expenditures of grant funds and test them against two standards:

- **Substantiation**—whether the expenditures were really made as claimed.
- **Allowability**—whether the expenditures were consistent with the grant agreement.

Beginning in 2013, KPMG will perform three different types of GEM reviews that vary in intensity based on the level of risk identified by the Risk Assessment Tool (see GEM Scope

Categories in the Tool Kit section for full description of the different types of reviews).

1. Desk Review (Low Risk): KPMG conducts the review via conference calls and document requests, focusing on the accuracy of grantee interim and final financial reports, and testing a selection of grant expenditures.

2. Basic Review (Moderate Risk): In addition to activities included in the Desk Review, KPMG conducts one site visit with the grantee to examine grant spend rate, grantee revenue sources and sustainability, and internal control policies and procedures.

3. Enhanced Review (High Risk): In addition to activities included in the Basic Review, KPMG conducts follow up site visits with the grantee to address specific issues related to financial management, use of funds, financial irregularities and accounting procedures.

This tiered-review structure will better align the review with the underlying need. Also, Knight and KPMG decided to make an examination of program and organizational controls standard in all basic and enhanced reviews, since many grantees cited the value of this exercise, which had been performed in only a handful of reviews.

## WHAT WE LEARNED ABOUT: CONDUCTING REVIEWS

KPMG originally used the same methodology for all reviews, which included a site visit and analysis of a standard proportion of expenditures. Knight realized over time that not every organization requires a full-scale review and resources could be deployed more effectively by offering low, medium, and high-intensity GEM reviews based on the grantee's needs and risk factors.

Meanwhile, the evaluation found that time spent by grantees participating in the review was in line with or below the expectations of more than half of grantees (55 percent). But 39 percent of grantees felt the time commitment was somewhat or much more intensive than expected, and grantees with awards of less than \$500,000 (59 percent) were more likely to say the intensity exceeded their expectations, furthering the case for a tiered-structure of reviews.




## D. REPORTING FINDINGS

Clear communication between Knight, the grantee and KPMG forms the key to successfully concluding each GEM review. Within a week of the review, KPMG sends Knight a note identifying any significant issues that may have been discovered, and a brief list of issues requiring immediate action. If KPMG has identified significant issues, Knight places a hold on future grant payments until the issues have been resolved.

KPMG sends Knight its full findings within three to four weeks of conducting the review. The report (see Findings Report Template in the Tool Kit section) contains an executive summary that lists issues and flags each issue as red, yellow, or green based on its severity. The report includes an Expenditure Observations section that reviews spending, and a Related Observation section describing governance, programmatic, fiscal or internal policy issues that may affect grant implementation. The report also recommends strategies for addressing issues and strengthening the grantee's governance, financial planning and operations.

The Knight Foundation CFO distributes reports internally to the program director overseeing the grant and vice president for that program team to solicit their responses, which they record in a section of the report reserved for program staff comments. Knight program staff



then forwards the reports to the grantee for responses, which they likewise record in a section of the report designed to capture grantee comments. After all comments are collected and any issues resolved, the finance team sends the final reports and responses to Knight's grants administration department, where they are uploaded into the foundation's electronic grants management system.

All GEM reports and follow-up actions are summarized in a quarterly note to the audit committee of Knight's board of trustees and discussed when the committee convenes each quarter. The GEM reports, audit committee summaries and copies of all letters sent to grantees are posted on Knight's intranet where program staff members can access them.

## REPORTING FINDINGS

The evaluations of the GEM revealed that the foundation needed to improve the process for finalizing the reviews. Almost 42 percent of grantees interviewed said they did not receive a final GEM report or that it was significantly delayed. Many grantees did not view Knight staff as deeply engaged in discussing the findings, with 26 percent saying Knight staff were not at all involved.

This led the foundation to take efforts to streamline the process for commenting on, finalizing, distributing and storing EM reports. This also led the foundation to create a project specialist staff position to manage logistics for the GEM program, including maintaining the GEM schedule and tracking the progress of each review.

Meanwhile, Knight staff reported struggles digesting the report findings, largely because the lengthy format made it difficult to identify which issues were truly important and urgent. This led the foundation to redesign the report and develop a new executive summary section to clearly outline and track progress in resolving significant issues.



## **E. RESOLVING ISSUES**

The GEM process requires clear procedures for resolving issues raised by the reviews. Since grant payments are frozen while issues from the review are resolved, it is important that Knight and the grantee act swiftly to address the items identified by the GEM.

When a report from KPMG identifies significant issues, Knight's CFO notifies grants administration to place a hold on future payments to the grantee until the findings are addressed by Knight program staff in consultation with the grantee. If KPMG's report has identified operational issues related to the implementation of the project, program staff manages the resolution of the issues with the grantee.



However, if KPMG's report identifies expenditure issues, meaning grant funds have been used for programmatic purposes that have not been approved of in the grant, Knight's CFO leads the development of corrective actions. In most cases, the grantee resolves expenditure issues by adding misspent funds back into the grant's account so they can be used to carry out the grant's programmatic purposes. In rarer instances where a project has been completed or fundamental conditions have drastically changed, misspent funds may be returned to Knight or redirected to another non-profit which can carry out the grant's purpose. Either way, Knight's CFO needs to confirm that the issues have been properly addressed.

After the issues have been resolved, Knight's finance department documents the corrective actions in a section of the KPMG findings report. Then, they send the report to Knight's grants administration team, which uploads the report into the foundation's grant management system and lifts the freeze on future payments to the grantee.


Each quarter, the CFO presents the audit committee of the board with outstanding issues identified in GEM reviews and explains the status of their resolution. If a resolution has not been reached for an issue, then that observation remains as an open item in committee reports until the issue is resolved and explained to the committee.

## RESOLVING ISSUES

GEM reviews consistently identify the same sorts of issues: cost sharing and matching requirements, treatment of indirect costs; grant closeout procedures, establishment of interest-bearing accounts for grant funds, re-budgeting thresholds and authority, and responsibility for unspent foundation funds at the end of projects.

Lack of clarity on these issues can cause delays and indecision on the part of grantees. Meanwhile, properly accounting for these issues during grants development by Knight program staff can help avert these issues. As the GEM program matures, Knight intends to develop clearer guidelines that address these common circumstances and communicate them to staff and grantees.

## II. IMPACT OF THE GEM PROGRAM



**T**he GEM program creates generates value in three distinct ways. For the Knight Foundation as a whole, the program improves financial oversight of its grant portfolio. For foundation staff, the program provides useful resources for managing grants. For grantees, GEM reviews provide an opportunity to assess internal practices and adopt stronger financial policies and procedures.



## IMPROVING FINANCIAL OVERSIGHT

The evaluation of the accounting methodology used by KPMG to conduct each GEM review praised the approach, concluding the reviews were well structured for achieving the goal of financial oversight. KPMG's reviews of grantees' expenditures are "high-quality, consistent and thorough," according to evaluators from RSM McGladrey, who also felt the reviews "help mitigate reputational, financial, operational and other forms of risk to the foundation." The evaluation also notes that a relatively high percentage of grantees' expenses were substantiated through the GEM reviews performed by KPMG between 2006 and 2011.

In turn, the GEM reviews have helped Knight identify instances which required intervention. In the 2 percent of reviews that uncovered significant issues, the reports led to the recovery of over \$8.2 million from 16 grantees (in amounts ranging from \$8,727 to \$2.6 million per grantee). In most cases, grantees redirected funds to their original program purposes, although a few returned the funds to Knight.

Importantly, grantees surveyed were overwhelmingly satisfied with KPMG's management of the review process and the veracity of their findings. Overall, 72 percent of grantees surveyed agreed that the findings were accurate and fair, compared to only 5 percent who disagreed.

## **SUPPORTING FOUNDATION STAFF**

The GEM program provides foundation staff with KPMG's business acumen and opens new lines of communication with their grantees. The program helps staff fully recognize, understand and address aspects of grantees' operations that might affect a grant's implementation and results. Knight staff has described the grant expenditure reviews as "a valuable grants management resource."

One program director, for example, was considering a major grant to a community development organization, but suspected that its governance structure had issues. The organization's director confirmed the concerns but had been unable to get his board to address the issue. The Knight program director gave the organization a small planning grant and requested a GEM review. Armed with recommendations KPMG provided during the review, the organization's director was able to focus his board's attention on the problem, and Knight built support for improvements in a subsequent grant.

GEM reports also serve as a documented record of prior grant activities that Knight staff and grantees can consult in cases of staff turnover. These records have been especially useful when a new program director joins the foundation or when the grantee organization hires a new leader who is not familiar with the grant history.



## STRENGTHENING GRANTEE OPERATIONS

Although GEM reviews primarily serve to provide financial oversight, the evaluation revealed that many grantees credit the reviews with strengthening their operations. This largely stems from the fact that the GEM process goes beyond a typical audit by examining governance structures, business sustainability plans and other elements of an organization's operations.

### **The evaluations yielded the following insights about how the GEM creates value for grantees:**

- Almost half (46 percent) of surveyed grantees found the review experience valuable and 43 percent said the KPMG report contained useful insights.
- A third of grantees (34 percent) said the review strengthened their ability to manage grant funds and operations.
- The most commonly reported improvements prompted by the GEM review were the ability to monitor compliance with grant activities (33 percent) and track grant funds (28 percent).
- Grantees with smaller awards (less than \$1 million) were more likely to report that the review strengthened their fund-raising capacity and sustainability planning, while grantees with larger awards (more than \$1 million) more often said the GEM improved their ability to monitor compliance and track grant funds.

For several nonprofits, the daily pressures of running an intensive initiative leave little time to review and strengthen core capacities, so having an independent party draw attention to them before they cause serious damage can be beneficial. Grantees cited several ways (see sidebar) that the reviews led them to make improvements to their internal capacities and procedures.

A final benefit of the GEM cited by grantees was that the reviews offered them a chance to speak candidly to a third party about sensitive issues, including how they feel Knight is managing their grant. The reviews have served as an important means of communication.

### **IMPROVEMENTS MADE BY GRANTEEES AFTER GEM REVIEW**

- Modify accounting procedures
- Develop accounting manuals
- Implement budget software
- Establish expenditure review policies
- Develop strategic marketing plans
- Improve sustainability planning
- Improve impact measurement
- Manage grants (Knight and others)




### III. LESSONS LEARNED



**K**night Foundation draws the following lessons about grant expenditure monitoring from the first five years of the GEM program and the feedback received through the evaluations:

- 1. Begin financial oversight during grants development.** Rigorous due diligence before awarding a grant encourages stronger communication between foundation staff and potential grantees, uncovers underlying risk factors earlier in the process and leads to more accurate grants budgets.
- 2. Review grants based on risk, not grant size.** The risk that a grantee will make unallowable or unsubstantiated expenditures is not directly tied to the size of the grant. When selecting which grant projects are most in need of monitoring and assistance, examine a broader set of factors that better predict risk.



**3. Customize reviews to fit the need.** Build flexibility into the process so monitoring activities and resources align with risk exhibited by the grant project. Reviews can vary by intensity and by scope, and the accounting partner may need to send more senior staff for complex projects.

**4. Evaluate grantee controls and procedures, not just expenses.** Financial management is vital to ongoing fiscal responsibility, but organizational capacities and programmatic practices also affect outcomes and therefore warrant attention.

**5. Communicate early and often with grantees.** Make written materials describing the grant monitoring and evaluation activities easily accessible to staff and grantees. Establish a process for sharing the findings report with the grantee and provide them with a chance to correct any misperceptions and develop a response.

**6. Develop a consistent approach to finalizing reviews.** Streamline the process for reviewing and discussing findings with grantees and program staff, including clear timelines and roles. Establish a centralized approach to monitoring the resolution of outstanding issues identified in the reviews.

**7. Encourage program staff participation.** Demonstrate the benefits of the program to staff and engage them in discussions about what needs they would like to address through the reviews. Knight will hold training sessions with staff to discuss the issues most commonly identified during the GEM reviews and how staff can help avoid these issues during grants development.

**8. Designate the right person to manage the program.** The ideal program manager should have finance expertise as well as an understanding of the grant programs. This will help them administer a program that balances financial accountability and oversight with grantee relationship development and capacity building.

The GEM program continues to evolve to address feedback from grantees and program staff, and account for the ongoing needs of the foundation. We are encouraged by the impact of the program including greater accountability for expenditures, more informed decisions by program staff, and stronger accounting procedures developed by grantees. We hope the lessons and tools in this guide will benefit others, and we plan to share further insights in the future as the GEM program evolves.

The following tools provide detail on key activities that occur during the selection of grants for GEM review, preparation for and participation in the review, and the reporting of findings.



- **GEM MANAGEMENT CHECKLIST FOR FOUNDATION STAFF** outlines the steps that program directors, vice presidents and the CFO take while managing a GEM review.



- **RISK-ASSESSMENT TOOL** examines the presence and severity of risk factors to determine whether to conduct a GEM review and the proper intensity for the review.



- **GRANTEE PREPARATION CHECKLIST** is sent by KPMG to grantees selected for GEM so they can prepare materials for the review.



- **AGREEMENT ON KPMG ROLE** is signed by the grantee prior to a GEM review.



- **GEM SCOPE CATEGORIES** explains the distinctions between low-, medium- and high-intensity GEM reviews.



- **FINDINGS REPORT TEMPLATE** shows how KPMG's findings are organized and presented to Knight staff and grantees.

## **GEM MANAGEMENT CHECKLIST FOR FOUNDATION STAFF**

### **PROGRAM STAFF AND VICE PRESIDENTS**

- Prepare GEM Risk-Factor Analysis and determine impact on grant structure and design
- Consult on pre-GEM meeting and planning for fieldwork
- Review GEM reports and follow up on and resolve KPMG observations

### **CHIEF FINANCIAL OFFICER**

- Oversee and manage entire program
- Act as a resource to program staff completing the GEM Risk-Factor Analysis
- Schedule GEMs
- Review all reports and follow up on observations as necessary
- Partner with program staff to immediately resolve any expenditure issues
- Report to the audit committee quarterly on GEM findings and resolution of issues

### **PROJECT SPECIALIST**

- Act as a resource to program staff completing the GEM Risk-Factor Analysis
- Schedule GEMs
- Coordinate with KPMG
- Track progress of GEMs to completion
- Provide support to program staff as they resolve GEM issues
- Ensure that issues are resolved by program staff and final reports are shared with grantees

### **FINANCE ASSOCIATE**

- Act as a resource to program staff completing the GEM Risk-Factor Analysis

# RISK ASSESSMENT TOOL

Knight Foundation is currently piloting this form as a way to analyze project risk during the grants development process. Program staff must complete the form for all grants >\$250,000 (and encouraged to use it as a due diligence exercise for smaller grants as well).

The weighting given to each response is still being tested - Knight recommends that any organization considering the adoption of risk assessment tool such as this should review the risk factors and consider adding, removing and/or adjusting the weighting of risk factors to meet the needs of their organization.

Factor	Score Weighting	Score	Staff Notes (optional)
<b>Grant Amount:</b> <i>What is the total value of the grant?</i>	<= \$250,000 = 1 <= \$500,000 = 2 <= \$750,000 = 3 > \$750,000 = 5		
<b>Expenditure Responsibility:</b> <i>Is it an expenditure responsibility grant?</i>	Expenditure responsibility = 5 Non-expenditure responsibility = 0		
<b>Fiscal Agent:</b> <i>Will a fiscal agent increase fiscal oversight?</i>	Using fiscal agent for added oversight = 0 Using fiscal agent due to capacity issues = 1		
<b>Prior Experience with KF:</b> <i>Has the grantee properly executed a previous Knight grant (performed project on time with no issues and fulfilled reporting requirements)?</i>	Proper execution of prior grant(s) = 0 No prior experience with KF = 2 Minor implementation issues in prior grant(s) = 3 Poor execution of prior grant(s) = 5		
<b>Financial Collaboration:</b> <i>Does project require close collaboration of multiple organizations carrying out interrelated activities funded by KF's grant?</i>	Sole organization = 0 Multiple organizations w/ executed MOU = 1 Multiple organizations w/o executed MOU = 2		
<b>Project Budget:</b> <i>Are costs clearly explained in the proposed budget narrative?</i>	Clear cost categories and explanations = 0 Undetailed budget categories = 2 Final budget does not equal grant amount = 3		
<b>Sub-Granting:</b> <i>Will grantee re-grant some or all of the funds?</i>	No sub-grants = 0 One sub-grant = 3 Two or more sub-grants = 4		
<b>Grantee Support For-Profit Third Parties:</b> <i>Will part or all of the grant funds be invested or loaned to for-profit third parties?</i>	Yes = 3 No = 0		
<b>Relevant Experience:</b> <i>Does grantee demonstrate experience managing projects of this type?</i>	Yes = 0 No = 2		
<b>Start-up Organization:</b> <i>Does the grant fund a new organization?</i>	Established organization = 0 Start-up organization = 3		
<b>Domestic/International:</b> <i>Does the grant project take place outside the U.S. or is managed by a foreign entity?</i>	Domestic = 0 International = 5		
<b>Audited Financial Statements:</b> <i>Does the grantee have audited financial statements less than one year old and did the audit opinion note any exception items?</i>	Audited financial statements with no exceptions = 0 Does not have audited financial statements = 2 Audited financial statements contain exceptions = 5		
<b>Staff Risk:</b> <i>Does grant implementation rely on 1-2 key personnel at the grantee?</i>	More than one person key to grant implementation = 0 One person, transition could be managed = 1 One person, transition would impact project = 2		
<b>Accounting Practices:</b> <i>Does the grantee have sufficient record keeping/ accounting capacity?</i>	Accounting staff/ general ledger system = 0 Lack of accounting personnel or practices = 3		
<b>Board Oversight:</b> <i>Does the grantee have a board of directors?</i>	Oversight by board = 0 No board/ limited involvement = 3		
<b>Percent of Operating Budget:</b> <i>What % of total operating budget does the grant represent?</i>	<= 5% = 0 <= 10% = 1 <= 25% = 2 > 25% = 3		
<b>Project dependence on Knight Funds:</b> <i>Is Knight the only funder for this project?</i>	Yes = 2 No = 0		
<b>Cash Reserve:</b> <i>How many months of operating budget does grantee have in cash reserves?</i>	<= 2 months = 3 <= 3 months = 2 <= 4 months = 1 > 5 months = 0		
<b>Other Funding Sources:</b> <i>Does the grant require grantee to raise matching funds to support the project?</i>	Other funding sources have committed = 0 Other funding required is pending/unsecured = 3		
<b>TOTAL SCORE</b>		???	

Total Score	GEM type
0-6	No GEM Needed
7-14	Category A
15-25	Category B
26+	Category C



# GRANTEE PREPARATION CHECKLIST

## **Grant-related documents:**

- a) Names, titles and contact information for key employees working on the project
- b) Detailed general ledger reports showing all grant expenditures from inception. The report should have transaction-level detail (i.e., date of expense, type of expense, etc.). A soft copy Microsoft Excel report is preferred for sorting purposes
- c) All interim and final narrative and financial reports relating to the grant that have been submitted to the foundation
- d) Invoices, receipts and/or vendor contracts for all grant expenditures (we will select a sample of expenses from item b above)
- e) Bank statements, account reconciliations and similar information used to track and allocate grant expenditures
- f) Indirect/overhead cost allocations as they apply to the foundation grant
- g) Copies of all contracting and/or sub-granting agreements, if applicable
- h) Copies of any grant modifications approved by the foundation, if applicable
- i) Copies of the grant proposal and grant budget that were submitted to the foundation for the grant
- j) Copy of the most recent analysis of grant budget-to-actual expenditures
- k) Copy of the most recent bank statement showing the balance of grant funds

## **Organizational documents:**

- l) The two most recent annual reports and financial statements (audited, if available)
- m) Federal and state tax and other governmental returns filed (or any similar informational federal or state filings) for the last two years
- n) List of the top 10 donors from the most recent fiscal year and the amount donated by each
- o) Accounting and financial management policies and procedures
- p) Expense reimbursement policies, especially with respect to travel- and entertainment-related expenditures
- q) Overhead allocation policy
- r) Conflicts of interest policy
- s) Board minutes for the time period covered by the grant
- t) Approval of tax exemption, charitable registration or other documentation establishing your status as a charitable or other type of nongovernmental organization
- u) Articles of incorporation, bylaws or other organizational documents
- v) Statement(s) of the organization's purpose, mission and activities; brochures, reports and materials describing the organization and its activities

# SAMPLE AGREEMENT ON KPMG'S ROLE IN THE REVIEW

John S and James L Knight Foundation (the "Foundation") follows procedures that require it to evaluate grantees, and the use made of the funds it grants. The Foundation has engaged KPMG LLP and other member firms of KPMG International ("KPMG") to assist the Foundation in performing its evaluations. The Foundation has asked KPMG to assist it in evaluating grants or potential grants to <GRANTEE NAME> (the "Grantee").

All the services provided by KPMG with respect to grants or potential grants are at the direction of, and for the benefit of, the Foundation. KPMG collects information about the Grantee, from a variety of sources, and its expenditure of the Foundation's grant funds, and communicates this information to the Foundation. KPMG also provides advice to the Foundation. The Foundation makes all decisions relating to grants, including whether the Grantee's grants are funded, the amounts of such funding, and the purposes for which grant funds can be utilized. As part of its responsibilities to the Foundation, KPMG may also provide services that have value to the Grantee.

All reports and other communications between the Foundation and KPMG are confidential. KPMG will not provide copies of such communications to the Grantee, unless instructed to do so by the Foundation.

The Foundation may ask KPMG, both as a service to the Grantee and to the Foundation, and at the Foundation's expense, to assist the Grantee in preparing financial information for the Foundation, to provide the Grantee with advice on tax or accounting matters, or to assist the Grantee in other ways. These services are intended to provide value to the Grantee, by helping build capacity, and assist the Foundation in meeting its reporting requirements and increasing the effectiveness of its grant-making programs.

\* \* \*

I understand and agree with the above. I also understand and agree to the following:

- It is not a conflict of interest for KPMG to provide assistance to the Grantee at the direction and expense of the Foundation.
- KPMG is not liable to the Grantee with respect to any services it provides to the Foundation, any information about the Grantee that it discloses to the Foundation or any assistance it provides to the Grantee at the direction and expense of the Foundation.
- This document shall be construed in accordance with the laws of the State of New York. Any claim concerning it or any other claim by Grantee against KPMG may only be brought in the courts of the State of New York.

<GRANTEE NAME>

\_\_\_\_\_  
Authorized Signature

\_\_\_\_\_  
Date

\_\_\_\_\_  
Printed Name

\_\_\_\_\_  
Title

# GEM SCOPE CATEGORIES

## **Category A: Desk Review GEM (7 – 14 POINTS)**

KPMG will review the accuracy of interim and final financial reports and will test a selection of grant expenditures. KPMG will also inquire with the grantee about basic internal control procedures as they pertain to managing grant funds. The review of grantee documents will occur at KPMG offices, but will include follow-up discussions with the grantee via conference calls and requests for relevant documentation. Findings and observations obtained during the review will be summarized in a GEM report. The GEM report will provide the foundation with information pertaining to the grantee's compliance with terms of the grant letter and will provide a conclusion on the foundation's compliance with the diverted-funds requirements under the expenditure responsibility rules of section 4945(h) and the separate fund requirement under section 4945(d)(5), as applicable.

(Estimated hours: 32–36; estimated fees: \$8,000)

## **Category B: Basic On-Site GEM (15-25 POINTS)**

A Basic On-Site GEM will include all portions of the remote GEM, in addition to a site visit conducted by KPMG personnel. During the site visit, the KPMG team will meet with relevant program and financial personnel to obtain an understanding of the grantee's management of the foundation's grant. The KPMG team will perform a basic analysis of the grant spend rate and gain an understanding of the grantee's revenue sources and high-level sustainability plans. The KPMG team will also review organizational documents, such as accounting and internal-control policies and procedures, as they relate to management of the grant. KPMG will inquire about involvement of the grantee's board of directors and gain an understanding of relationships between parties such as fiscal agents and sponsors. Findings, observations and any other relevant information obtained during the site visit and the review of grant related documents will be included in the GEM report submitted to the foundation.

(Estimated hours: 45–55; estimated fees: \$12,500)

## **Category C: Enhanced On-Site GEM (26+ POINTS)**

An Enhanced On-Site GEM will include all portions of the Basic On-Site GEM. In addition, this type of GEM will focus on specified areas of financial management, as identified by the foundation and may include questions on the use of funds for significant capital expenditures, previously identified inconsistencies in interim financial reports, suspected misuse of funds, concerns around allocation procedures, known project or organizational sustainability concerns, programmatic challenges for which the foundation's program officer has been unable to obtain satisfactory information, high dollar value expenditures (generally greater than \$1.5 million) for which the foundation would not like to reduce sample size, multiyear grants on which a GEM has not been performed for three years, grants for which there has been a significant turnover in management at the foundation (thereby requiring enhanced clarification of the grant history). grants awarded to a grantee with multiple site locations, or endowment grants .

(Estimated hours: 65+; estimated fees: \$20,000+)

<sup>1</sup>Please note that for all Categories of Evaluation, all fees are quoted exclusive of any associated out of pocket travel expenses.

<sup>2</sup>Endowment grants may be further separated into different scopes depending on the nature of the endowment. Knight Chair endowments tend to be more complex than other types of endowments. Non-

# GEM SCOPE PROCEDURES

GEM Procedures	Category A: Desk	Category B: Basic	Category C: Enhanced
KPMG internal risk management procedures, including conflict checks and obtaining a signed 'Role of KPMG'	X	X	X
<b>Grant-related Finance Procedures</b>			
General ledger detail agreed to financial report submitted	X	X	X
Verify bank account/fund maintains balance of grant funds	X	X	X
Grant expenditures testing for substantiation and allowability (grant expenditures up to \$1.5M)	X	X	X
Grant expenditures testing for substantiation and allowability (grant expenditures over \$1.5M)			X
On-site visit with grantee		X	X
Review practices for tracking grant funds across donors		X	X
Evaluate spending rate of the grant		X	X
Review sub-grantee selection and monitoring process		X	X
Analyze endowment grant market value and disbursements (Basic = current year, Enhanced = multi-year)		X	X
Reconciliation of financial report and actual expenditures		X	X
Review of allocation calculations		X	X
<b>Organizational / Operational Procedures</b>			
Confirm registration with regulatory/oversight authorities	X	X	X
Review most recent audited financial statements	X	X	X
Review current and future funding sources	X	X	X
Review grantee internal-control procedures	X	X	X
Review policy and procedures manuals (accounting manuals, reimbursement policies, time-tracking policies, segregation-of-duties policies)		X	X
Review of additional parties involved in grant management, such as fiscal agents or sponsors, parent organizations, etc.		X	X



Org. / Op. Procedures continued	Category A: Desk	Category B: Basic	Category C: Enhanced
Review financial management experience of grantee staff and officers to evaluate capacity to manage grant funds.		X	X
Inquire about trustee involvement in organization		X	X
Evaluate any legal or contractual agreements or pending actions that may impact ability to perform the grant		X	X
Discuss project and organizational sustainability plans			X
Programmatic Procedures			
Project status review and timeline of key activities		X	X
Monitoring and evaluation plan, and staff capacity to perform			X
Investigation of specific issues cited by program staff			X
Reporting Procedures			
Written report with observations and recommendations noted during the evaluation and a conclusion on:	X	X	X
• The diverted-funds requirements under the expenditure responsibility rules of section 4945(h)			
• The separate-fund requirement under section 4945(d)(5)			
• The substantiation and allowability standards			

# FINDINGS REPORT TEMPLATE

**ORGANIZATION NAME:** XXXXXX

**GRANT ID:** XXXX-XXXX

**KNIGHT PROGRAM TEAM:** XXXXXXXX

**KNIGHT PROGRAM OFFICER:** XXXXXXXX XXXXXXXX

**RATING**

**XXX**

## GRANT PURPOSE

## EXPENDITURE OBSERVATIONS DISCUSSION OF IMPACT

<TO BE COMPLETED BY KNIGHT FOUNDATION>

### FOLLOW UP ISSUE

### SEVERITY

Tag	Description	RATING
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## OPERATIONAL OBSERVATIONS DISCUSSION OF IMPACT

<TO BE COMPLETED BY KNIGHT FOUNDATION>

### FOLLOW UP ISSUE

### SEVERITY

Tag	Description	RATING
Tag	Description	RATING
Tag	Description	RATING
Tag	Description	RATING
Tag	Description	RATING

## REPORT TIMELINE

**KPMG Findings Delivery:** XX Month Year

**Knight Staff Response:** XX Month Year

**Grantee Response:** XX Month Year

**Report Finalized:** XX Month Year



**ORGANIZATION NAME:** XXXXXX

**GRANT ID:** XXXX-XXXX

**KNIGHT PROGRAM TEAM:** XXXXXXXX

**KNIGHT PROGRAM OFFICER:** XXXXXXXX XXXXXXXX

**RATING**

**XXX**

**GRANT PURPOSE**

**EXPENDITURE OBSERVATIONS DISCUSSION OF IMPACT**

<TO BE COMPLETED BY KNIGHT FOUNDATION>

**FOLLOW UP ISSUE**

**SEVERITY**

**Tag**

**Description**

**RATING**

**OPERATIONAL OBSERVATIONS DISCUSSION OF IMPACT**

<TO BE COMPLETED BY KNIGHT FOUNDATION>

**FOLLOW UP ISSUE**

**SEVERITY**

**Tag**

**Description**

**RATING**

**Tag**

**Description**

**RATING**

**Tag**

**Description**

**RATING**

**Tag**

**Description**

**RATING**

**Tag**

**Description**

**RATING**

**REPORT TIMELINE**

**KPMG Findings Delivery:** XX Month Year

**Knight Staff Response:** XX Month Year

**Grantee Response:** XX Month Year

**Report Finalized:** XX Month Year

### PAST GEM RATINGS

XX Month Year  
Grant Number:



XX Month Year  
Grant Number:



XX Month Year  
Grant Number:



Not Applicable



### STATUS OF PRIOR GEM OBSERVATIONS

#### PRIOR ISSUE

1. Description
2. Description
3. Description
4. Description
5. Description
6. Description
7. Description
8. Description

#### CURRENT STATUS

- Description
- Description
- Description
- Description
- Description
- Description
- Description
- Description



## Grantee Background and Progress Update

**Grant total:**  
**\$XXX,XXX**

**Schedule of Payments:**

- 1. \$XXX,XXX**
- 2. \$XXX,XXX**
- 3. \$XXX,XXX**
- 4. \$XXX,XXX**

**Grant expenditure monitoring:**  
**\$XX,XXX**

**ACTUAL PAYOUT:**  
**\$XXX,XXX**

**Total expenditures as of**  
**<DD MONTH YEAR>:**  
**\$XXX,XXX**

**Expenditure Monitoring:**

**XXX**

<<BASED ON THE RESULTS OF KPMG'S GRANT EXPENDITURE MONITORING, KPMG IS NOT AWARE OF ANY EXPENDITURE(S) THAT WOULD CONSTITUTE DIVERTED FUNDS WITHIN THE MEANING OF THE EXCISE TAX REGULATIONS.

FURTHER, DURING THE GRANT EXPENDITURE MONITORING NOTHING WAS BROUGHT TO KPMG'S ATTENTION THAT WOULD LEAD IT TO CONCLUDE THAT THE GRANTEE DID NOT HAVE ADEQUATE CONTROLS, FINANCIAL MANAGEMENT, OR GRANTS MANAGEMENT IN PLACE TO PROPERLY MANAGE THE FOUNDATION'S GRANT FUNDS.>>

**OR**

<<BASED ON THE RESULTS OF KPMG'S GRANT EXPENDITURE MONITORING, KPMG IDENTIFIED EXPENDITURE(S) THAT MAY CONSTITUTE DIVERTED FUNDS WITHIN THE MEANING OF THE EXCISE TAX REGULATIONS.

FURTHER, DURING THE GRANT EXPENDITURE MONITORING KPMG IDENTIFIED ISSUES WITH THE GRANTEE'S CONTROLS, FINANCIAL MANAGEMENT, OR GRANTS MANAGEMENT SYSTEMS THAT MAY IMPEDE THE GRANTEE'S ABILITY TO PROPERLY MANAGE THE FOUNDATION'S GRANT FUNDS.>>

The John S. and James L. Knight Foundation made one grant to <GRANTEE> <INCLUDE <sup>1</sup> IF MGD IS REQUIRED> in accordance with a grant commitment letter ("Grant Letter"). Grant # <0000-0000> was in the amount of <US \$>, payable in <#> installments of <US \$>. <INSERT DESCRIPTION OF PAYMENTS RECEIVED. E.G., The first installment was paid on 1 December 2008 and the second will be made upon submission of a successful interim report.> The grant was made in <City, State> and used for <Program Description>. To date <US \$> has been received by <GRANTEE>. Total grant expenditures to <DATE> are <US \$>.

<GRANTEE NAME>, located in City, State, is <Insert Organization Type, e.g., 501(c)(3) non-profit, tax exempt organization> that was formed in <Year> to <Insert Grantee's mission>. The John S. and James L. Knight Foundation's grant was awarded specifically to <insert project description>.

<Use remaining space to describe objectives of the grant and provide a basic project update. The update should be fact based and should not express any KPMG opinions with respect to progress on the grant.>

<sup>1</sup> <INCLUDE MUTUAL GRANTEE DISCLOSURE(S) HERE AS REQUIRED>

**GENERAL LEDGER DETAIL>.** The test sample included approximately <E.G., 70> percent of <INSERT DESCRIPTION OF SAMPLE SELECTION; I.E. WHICH ACCOUNTS WERE INCLUDED, ETC.>

## Expenditure Observations

Expenditure, <Label 1>

### ISSUE 1: <ISSUE ONE TITLE>

<DESCRIPTION >

<Issue >

#### Recommendation:

<Recommendation goes here>

#### Knight Foundation Response:

<INSERT FOUNDATION RESPONSE>

#### Grantee Response:

<INSERT GRANTEE RESPONSE>

#### RESOLUTION:

<INSERT RESOLUTION>

## Operational Observations

Operational, <Label 1>

### ISSUE 1: <ISSUE ONE TITLE>

<DESCRIPTION >

<Issue >

#### Recommendation:

<Recommendation goes here>

#### Knight Foundation Response:

<INSERT FOUNDATION RESPONSE>

#### Grantee Response:

<INSERT GRANTEE RESPONSE>

#### RESOLUTION:

<INSERT RESOLUTION>



Operational, <Label 2>

## ISSUE 2: <ISSUE ONE TITLE>

<DESCRIPTION >

<Issue >

### Recommendation:

<Recommendation goes here>

### Knight Foundation Response:

<INSERT FOUNDATION RESPONSE>

### Grantee Response:

<INSERT GRANTEE RESPONSE>

### RESOLUTION:

<INSERT RESOLUTION>

Operational, <Label 3>

### ISSUE 3: <ISSUE ONE TITLE>

<DESCRIPTION >

<Issue >

#### **Recommendation:**

<Recommendation goes here>

#### **Knight Foundation Response:**

<INSERT FOUNDATION RESPONSE>

#### **Grantee Response:**

<INSERT GRANTEE RESPONSE>

#### **RESOLUTION:**

<INSERT RESOLUTION>

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